Imperial Rule.(International Monetary Fund receives $18 billion from Congress)(Abstract)

Distant and out of touch, the IMF ruins economies great and small.

OVER the past two decades, the International Monetary Fund has promised cheap loans to foreign governments in order to bribe them into pursuing suicidal economic policies designed by IMF technocrats, rather than by their own elected representatives. This costly global meddling was supposed to make the world economy a safer, more stable place. Needless to say, it has not. Yet international crises that the IMF neither foresaw nor forestalled have been used to persuade Congress to send the IMF another $18 billion. Congressional Republicans added some "transparency" conditions: the IMF will publish summaries of some decisions and deals. And there will be a commission to study the IMF. But Congress backed away from trying to impose requirements that borrowing countries reduce trade barriers and end political favoritism in lending, or that they repay loans within 18 months at a relatively high interest rate. Even these abandoned reforms would have been toothless. The U.S. has 1 vote out of 182 in the IMF. The Treasury Department exerts considerable influence over IMF policy, but that is neither a source of comfort nor something Congress can control. In any case, Congress appears to have focused on two relatively mild criticisms of the fund: moral hazard and lack of transparency. "Moral hazard" means that bailouts of bad loans encourage more bad loans. Proposals to make IMF loans shorter-term and more expensive are designed to alleviate it. But if the IMF is to become more cautious and restrictive in its lending, it doesn't need more money: money repaid by one country will become available to loan to another. On the other hand, another $18 billion from the U.S., and $72 billion from other countries, ensure that the outstanding volume of IMF loans will greatly increase-and so will moral hazard. The transparency problem is that the IMF never reveals the strings it attaches to loans. Congress supposes that if the IMF published sanitized reports on what it had been doing three months earlier, this would somehow improve the quality of the demands it places on its wards. This notion is remarkably innocent. The IMF has 2,300 experts who can rationalize any sort of mischief, and in ways that would make Alan Greenspan's remarks appear simple and clear by comparison. A far more serious problem is the IMF's long history of doing much harm and no good. (For more details see my lengthy study, "The IMF's Destructive Recipe: Rising Tax Rates and Falling Currencies, " in Money and the Nation State, edited by Kevin Dowd and Richard Timberlake and published by Independent Institute.) The IMF nearly always requires countries to devalue their currencies or raise tax rates or both. The IMF has also favored wage controls, and at least condoned higher tariffs. This sort of IMF formula was first applied to Peru and Jamaica in 1978, where real income per capita subsequently fell by 13 to 14 per cent. The next such adjustment programs were in Nicaragua and Bolivia after 1980, where real output subsequently fell by 13 and 28 per cent respectively. A more recent example was Haiti, where a 1990 IMF program (described by the World Bank as an effort "to increase fiscal revenues") was followed by a prolonged 24 per cent drop in GDP. The casualty list Any list of countries " helped" by IMF programs reads like a casualty list. The start of the IMF's painful involvement in Yugoslavia was candidly described in the 1989 issue of the World

Bank's publication, Trends in Developing Countries: "The dinar was devalued in real terms by 19.3 per cent [and] strict limits were imposed on the growth of nominal wages. . . . The program was supported by the IMF. . . . Output declined about 2 per cent, and inflation accelerated to 251 per cent by the end of the year. The unemployment rate has been rising, and the real income of the population declined by at least 2 per cent." The same sort of destabilization program was pawned off on several Latin American countries. To obtain a two-year IMF loan in 1982-83, for example, Chile deeply devalued the peso, raised tariffs from 10 per cent to 35 per cent, and raised income-tax rates. The economy collapsed, and inflation soared. Chile completely reversed those policies in 1984- 85, and later ended an onerous payroll tax by privatizing Social Security. Since escaping the clutches of the IMF, Chile has become a model for development. The IMF's track record in East Asia is no better. South Korea adopted an IMF program in 1980, including a 17 per cent devaluation and a huge increase in the highest income-tax rates. The economy shrank by 5 per cent, and inflation hit 35 per cent. As soon as the term of the IMF loan ended in February 1981, the Korean government began to slash tariffs and tax rates. This was followed by nearly two decades of astonishing economic growth, an achievement tarnished but not undone by Korea's latest disastrous experiment with currency devaluation. The Philippines went through a similar experience in the Eighties: devaluation, higher taxes, inflation, and shrinking GDP under IMF tutelage, followed by revolution, a reversal of IMF policies, and 5 to 6 per cent economic growth. In 1990-91, however, a new IMF "stabilization program" entailed another devaluation, a new 10 per cent VAT, and an extra 9 per cent import tariff. Economic growth in 1991-92 was below zero, and inflation rose from below 4 to nearly 19 per cent. The IMF's role in promoting higher tariffs is rarely so direct, and yet tariffs tend to follow from its obsession with budget and trade deficits. A tariff seems to attack the alleged "twin deficits" at both ends, cutting both imports and the budget deficit; hence tariffs are often condoned if not actively promoted. At times, the IMF missionaries appear to act as if all countries should run trade surpluses, although this does not add up. They also seem to believe that all countries can become more "competitive" by repeatedly devaluing their currencies against one another, also arithmetically impossible. Thus, the IMF teams have been telling each of the wounded Asian tigers to slash imports and expand exports. But most Asian trade takes place within the region. That means one country's reduced imports must be a neighboring country's reduced exports. The so-called Asian "contagion" is largely a matter of IMF design, not some inexplicable accident. Twin peaks Why does the IMF focus so single-mindedly on the trade or "current account" deficit? Because slashing imports and redirecting production away from domestic uses into exports is supposed to free up more cash with which poor countries can pay interest to the multinational banks, including the *IMF.* The IMF's infamous obsession with squeezing more tax revenue out of troubled economies actually follows from its mercantilist habit of treating imports as evil. That is because the Fund has another strange theory, that of "twin deficits." Illustrious proponents of the twin-deficits theory confidently predicted, a few years ago, that any budget surplus in the United States would be matched by a trade surplus. Wrong. According to the twin-deficits theory, today's huge budget deficit in Japan would be matched by an equally huge Japanese trade deficit. Wrong again. Yet in The Economist of October 3, the IMF's chief economist, Stanley Fischer, was still recycling this twin- deficit theory to excuse the lunacy of trying to force collapsing economies into a big budget surplus. In late 1997, this weird twin- deficits theorizing fostered a higher VAT or higher oil taxes in some Asian countries, and higher tariffs in at least two. Bad ideas produce bad policies. Is it too much to ask for a single **IMF** success story? Jeff **Sachs** of MIT once cited Turkey as the only **IMF** success he could find. Others have suggested the Ivory Coast or Peru. But whatever success those countries had was the result of pursuing policies the opposite of those the **IMF** invariably demands. In 1992-93, Peru cut the top tax from 50 per cent to 30 per cent, eliminated excise taxes, and slashed tariffs. That was no **IMF** program. As for the Ivory Coast, real GDP fell for six years in a row after the country adopted an **IMF** program in 1986. Other distressed countries have succeeded without the **IMF**'s "help." For example, in 1985 Singapore ended a serious recession by, among other things, slashing the top income-tax rate from 45 per cent to 30 per cent. Its economy has grown by nearly 8 per cent a year ever since. Bolivia and Mauritius ended hyperinflations via tax cuts in the Eighties. What all such miraculous turnarounds have in common is some combination of lower tax rates and tariffs and an institutional device to make currency devaluation unlikely. If the **IMF** can really be reformed, the effort needs to begin with a clear statement of what it is expected to do. It is not and cannot be a "lender of last resort" in any meaningful sense. About all it can do is shift debt risk from frivolous lenders to innocent taxpayers. Besides, the most troubled countries have more than enough debt, much of it to the **IMF.** At most, the **IMF** should provide short-term loans to cover liquidity crunches for a few weeks, not bailouts for insolvent banks and firms that continue for years. And the **IMF** should use insurance techniques to set rates higher for risky countries and frequent borrowers. The politics of this issue are tainted by the huge amount of money involved. American industrial and farm lobbies imagine that more **IMF** loans would translate into greater exports to the borrowers, even though slashing those countries' imports is the **IMF**'s main goal. Multinational banks dream that more **IMF** loans will make it unnecessary to lose money on foreign loans that went sour, even though conditions attached to **IMF** loans often ruin the countries' creditworthiness. Meanwhile, the hotter the global financial fires, the more likely it is that the **IMF** will reach for the gasoline pump instead of water.

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